The Daily Dish

The Debt Threat

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Eakinomics: The Debt Threat

On Thursday at 10:00 a.m. the House Financial Services Committee will hold a hearing entitled “The Peril of an Ignored National Debt,” and yours truly has been invited to testify. At first blush, one might think this topic is better suited for a hearing at the Budget Committee, or even a hearing at the Ways & Means or Energy & Commerce Committees with jurisdiction over the entitlement spending programs at the center of the federal budget. That might make sense from a process point of view, but it misses the fundamental economic point that financial markets are the circulatory system of the economy and U.S. Treasuries are the lifeblood of the global financial system. Anything that threatens the solvency or liquidity of Treasuries — be it debt ceiling disasters or bipartisan budget malfeasance — threatens these all-important financial markets. Since the federal government is now the most systemically important (unsound) financial institution, it is entirely appropriate that there be Financial Services Committee oversight.

As for the debt, the level is high and the future is daunting. In looking at dealing with the tsunami of red ink, all roads lead to the entitlement programs. Medicare is projected to grow at 8 percent on average over the next decade and is currently running a cash deficit of over $330 billion. Social Security is projected to grow at an average rate of 6 percent, while currently running a cash-flow deficit of $41 billion. Medicaid and the insurance subsidies associated with the Patient Protection and Affordable Care Act (ACA) are growing at 6 and 5 percent on average every year. In contrast, the economy that is the ultimate source of financing for these obligations is projected to grow at only 4 percent annually. In short, there is no way to simply “grow our way out” of the debt explosion.

Purely budget-driven arguments are unlikely to be persuasive regarding entitlement reform. The large entitlement programs need reform in their own right, however. Social Security is a good example: Under current law, retirees will face a 23-percent across-the-board cut in benefits in less than two decades. That is a disgraceful way to run a pension system. It is possible to reform Social Security to be less costly overall and financially sustainable over the long term. A similar case can be made for Medicare and Medicaid, the key health safety nets for the elderly and poor. These programs have relentless appetites for taxpayer dollars, yet do not consistently deliver quality outcomes. Reforms can address their open-ended draws on the federal Treasury and improve their functioning at the same time.

Coming to terms with the debt is essential. That means coming to terms with entitlement reform. Faster growth will help. More revenue can push back the day of reckoning. But there is no substitute for a fair, effective and financially sustainable safety net.